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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947.

No. 221 .

No. 222 .

MORRIS EISENBERG,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

HERMAN SCHAEFFER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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Supreme Court of the United States

OCTOBER TERM, 1947.

No. .

No. .

Morris Eisenberg, Petitioner,

v.

Commissioner of Internal Revenue.

Herman Schaeffer, Petitioner,

v.

Commissioner of Internal Revenue.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioners, MORRIS EISENBERG and HERMAN SCHAEFFER, by their attorneys, HIRSH W. STALBERG, ESQ., and SHAPIRO, CONNER, ROSENFELD and STALBERG, ESQS., respectfully pray that writs of certiorari issue to review

the orders, judgments and decrees of the United States Circuit Court of Appeals for the Third Circuit in the above entitled cases, affirming decisions of the Tax Court of the United States, which orders, judgments and decrees were rendered by the Circuit Court of Appeals on April 22, 1947.

The Tax Court rendered decisions against the petitioners, and filed a consolidated opinion, sustaining deficiencies assessed by the Commissioner for the years 1940 and 1941. On appeal, the Circuit Court likewise filed a consolidated opinion, but entered separate orders, judgments and decrees in the two cases, affirming the decisions of the Tax Court.

STATEMENT OF THE MATTER INVOLVED.

This case involves the taxability of trust income to the settlor, in a family partnership case, where the trust beneficiaries are minor children of the settlor.

Eisenberg and Schaeffer were partners in a furniture business under an oral agreement from early in 1937 to December 30, 1939 (R. 8, 9). On December 30, 1939, they entered into a written agreement of partnership which stated that it reduced to writing the terms of the oral partnership, under which they had been operating, and fixed the future term at a year, subject to automatic renewals in default of notice to the contrary (R. 9-12).

Under this written agreement the partners retained equal shares of capital (R. 10) and shared equally in profits and losses (R. 12). Each was entitled to draw $7800.00 per annum for services, the drawings not to be deducted from profits, but to be considered an expense of doing business (R. 11). Profits could not be distributed except by consent of all partners (R. 11).

On January 2, 1940, each partner created trusts for his respective minor children—one to each (R. 12). Each partner was the trustee in the trusts he created, with

broad powers of management and control in himself as trustee. Each partner distributed among the trusts one-half of his interest in the partnership, leaving Eisenberg holding a one-fourth share in the capital of the partnership; Schaeffer a one-fourth share; the Eisenberg trusts in the aggregate a one-fourth share; and the Schaeffer trusts in the aggregate a one-fourth share (R. 12-17).

On the next day, January 3, 1940, each trust became a partner in the business (R. 17). As of January 1, 1940, capital accounts were set up on the business books for each of the trusts reflecting the various assignments of fractional interests in the business to each (R. 17-19). The same written partnership agreement which had formerly bound Eisenberg and Schaeffer as partners now bound the trusts as well, under the same terms and conditions (R. 17).

Except for negligible sums, no profits were distributed to the trusts for the taxable years (R. 18). Federal gift tax returns reporting the gifts in trust were filed (R. 19).

In their respective income tax reports as trustees for the taxable years, Eisenberg and Schaeffer reported income of the partnership credited on its books to the trusts (R. 18).

The Commissioner's position is that Eisenberg and Schaeffer should be taxed individually on all net income of the partnership, including that attributable to the interests of the trusts (R. 23). The Tax Court upheld that position (R. 30, 31).

The Tax Court made no fact finding that either the trusts or the partnerships were invalid for tax purposes, although the Commissioner specifically contended that the settlors still remained the owners of the trust property and that no actual partnerships were created (R. 23, 24). The Tax Court did conclude as a matter of law that the tax should be imposed upon the petitioners (R. 23-27).

The Circuit Court affirmed the decisions of the Tax Court (R. 43, 44).

In its opinion, the Circuit Court quoted and affirmed the principle of United States *v.* Morss, 159 F. 2d 142 (CCA 1st, 1947), that a "grantor of a trust remains taxable on the trust income under Section 22(a) where the benefits directly or indirectly retained by him blend imperceptibly 'with the normal concepts of full ownership'" (R. 41).

The Circuit Court proceeded to declare that the Tax Court's determination, if supported by the facts, was conclusive (R. 41).

The Circuit Court then said (R. 42):

> "• • • it is sufficient that the rights retained enabled them" (the taxpayers) "to make distributions to the minor beneficiaries according to their discretion, and to continue to use both the corpus and the income of the trusts in the partnership business exactly as though they were the owners thereof, without right in the beneficiaries to receive any distribution until the termination of the trusts as hereinbefore mentioned."

The Circuit Court discounted the argument of the petitioners that they could have prevented distribution of the trusts only by denying distribution to themselves, and asserted that by adjustment of salaries the petitioners could siphon off all net income merely by executing a written agreement on or before the first of each year (R. 42). Hence, the Circuit Court declared, the Tax Court might reasonably conclude on the facts, as it did, that the arrangements made by the petitioners did not effect a change in their economic status, but multiplied in form a single economic unit (R. 42).

For the latter conclusion, the opinion of the Circuit Court cited Helvering *v.* Clifford, 309 U. S. 331, 60 S. Ct. 554, 84 L. Ed. 788 (1940), and Losh *v.* Commissioner, 145 F. 2d 456 (CCA 10th, 1944) (R. 42).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 1141 of the Internal Revenue Code (53 Stat. 164; U. S. C. A., Title 26, Sec. 1141), and Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938; U. S. C. A., Title 28, Section 347).

The judgments of the United States Circuit Court of Appeals for the Third Circuit, to be reviewed, were entered on April 22, 1947 (R. 43, 44).

QUESTION INVOLVED.

Where a member of a partnership creates a trust for his minor children of a portion of his interest in the partnership, with himself as trustee and with broad powers of control as such trustee, and the trust becomes a member of the partnership, is the income of such a trust derived from partnership profits taxable to the settlor?

REASONS RELIED ON FOR ALLOWANCE OF WRITS.

In holding that income from gifts of partnership interests in trust for children of the partners is taxable to the partners creating the trusts, the Circuit Court of Appeals for the Third Circuit

1. has rendered a decision in conflict with the decisions of other Circuit Courts of Appeals on the same matter: Montgomery *v.* Thomas, 146 F. 2d 76 (5th Circuit); Commissioner *v.* Olds, 60 F. 2d 252 (6th Circuit); Armstrong *v.* Commissioner, 143 F. 2d 700 (10th Circuit); Thomas *v.* Feldman, 158 F. 2d 488 (5th Circuit);

2. has decided an important question of Federal law which has not been, but should be, settled by the Supreme Court of the United States.

WHEREFORE, your petitioners respectfully pray that writs of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Third Circuit, sitting at Philadelphia, Pennsylvania, commanding that Court to certify and to send to this Court on a day certain to be therein named a full and complete transcript of the record and all proceedings had in these cases numbered and entitled on its docket October Term, 1946, Nos. 9139 and 9140, to the end that these cases may be reviewed and determined by this Court; that the said orders, judgments and decrees of the United States Circuit Court of Appeals for the Third Circuit may be reversed by this Court, and that your petitioner may have such other and further relief in the premises as may seem just and proper.

And your petitioners will ever pray.

HIRSH W. STALBERG,
SHAPIRO, CONNER, ROSENFELD & STALBERG,
By

HIRSH W. STALBERG,
Attorneys for Petitioners.

Supreme Court of the United States

October Term, 1947. Nos. .

Morris Eisenberg, Petitioner,

v.

Commissioner of Internal Revenue.

Herman Schaeffer, Petitioner,

v.

Commissioner of Internal Revenue.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

OPINIONS BELOW.

The opinion of the Tax Court appears in the record at pages 7 to 29. It is reported in 5 T. C. 856.

The opinion of the Circuit Court of Appeals for the Third Circuit appears in the record at pages 34 to 43. It is reported in 161 F. 2d 506.

JURISDICTION.

The grounds on which jurisdiction of this Court is invoked are set forth in the Petition at page 5 thereof, and will not be repeated here.

STATEMENT OF THE CASE.

The statement of the case appears in the Petition at pages 2 to 4, and in the interest of brevity is not repeated herein.

SPECIFICATION OF ERRORS.

The errors which the petitioners will urge, if Writs of Certiorari be granted, are that the Circuit Court of Appeals for the Third Circuit erred

1. in affirming the judgment of the Tax Court;
2. in holding reasonable, despite the Tax Court's studied refusal to find that no actual partnership was created or that the petitioners remained the owners of the trust property, the conclusion of the Tax Court that the arrangements made by the petitioners did not effect a change in their economic status, but multiplied in form a single economic unit;
3. in holding invalid for tax purposes, despite the Tax Court's failure to find that there was no actual partnership or that the trusts did not effect a change of ownership, irrevocable trusts of portions of the interest of partners in a partnership business, executed by those partners for the benefit of their respective minor children.

STATUTE INVOLVED.

Sections 11, 12, 22(a), 181, 182, 183(a), and 3797(a) (2) of the Internal Revenue Code, Act of February 10, 1939, as amended, 53 Stat. 5, 9, 69, 70, 469; U. S. C. A. Title 26, Secs. 11, 12, 22(a), 181, 182, 183(a), 3797(a) (2).

ARGUMENT.

A. Reversal on Merits.

The Circuit Court, in upholding the conclusion that irrevocable trusts of partnership interests for children did

not relieve the settlors of income tax liability, proceeded upon the reasoning of cases involving the interests of wives.

Those cases are the now famous decisions of Helvering *v.* Clifford, 309 U. S. 331, 60 S. Ct. 554, 84 L. Ed. 788 (1940); Commissioner *v.* Tower, 327 U. S. 280, 66 S. Ct. 532, 90 L. Ed. 670 (1946), and Lusthaus *v.* Commissioner, 327 U. S. 293, 66 S. Ct. 539, 90 L. Ed. 679 (1946).

None of those cases considers the rights of children as distinguished from those of wives in similar situations. None of those cases specifically rules that a trust for a child beneficiary may not legitimately form a component of a partnership for income tax purposes. That precise question has not been passed upon by this Court.

In some Circuits, where the question has arisen with respect to children, the courts have upheld gifts of interests in partnerships as valid under the Internal Revenue Code. One Circuit has so decided after the *Tower* and *Lusthaus* cases. Some Circuits have held the contrary.

In Armstrong *v.* Commissioner, 143 F. 2d 700 (1944), the Circuit Court of Appeals for the Tenth Circuit sustained a conveyance by the owner of a business of a fractional share to himself in trust for minor children, reserving broad powers of management and control.

In Montgomery *v.* Thomas, 146 F. 2d 76 (1944), the Circuit Court of Appeals for the Fifth Circuit recognized as valid a partnership composed of a father and his minor sons, even though the sons rendered no services and their only capital contributions comprised the dividends upon stocks bought with money received from their father as gifts.

In Commissioner *v.* Olds, 60 F. 2d 252 (1932), the Circuit Court of Appeals for the Sixth Circuit sustained gifts by a father to three daughters of shares in his business, though the father retained full control and the right to give his daughters, from time to time, what he saw fit out of the profits.

In Thomas *v.* Feldman, 158 F. 2d 488 (November 22, 1946), the Circuit Court of Appeals for the Fifth Circuit approved partnership trusts for minor children, even though the father retained full control of the partnership management. That case, it will be noted, was decided since the *Clifford, Tower* and *Lusthaus* cases.

In the last mentioned case, which was appealed from a Texas District Court, the father created limited partnerships, which included his wife and the trusts for minor children. The father remained the general and managing partner. The District Court found that the gifts creating the trust were bona fide, valid and irrevocable; and that since their creation the father had used none of the corpus or income of the trust either to maintain his children or for his personal benefit.

As to the wife, the Circuit Court declared that the validity of the partnership was not involved because the Texas community property law assigned one-half of the income of the husband to the wife irrespective of the partnership agreement.

As to the trusts, the Circuit Court distinguished the *Clifford, Tower* and *Lusthaus* cases, on the ground that they were not controlling, because of different fact findings below.

In the *Clifford* case, the Circuit Court pointed out, the Supreme Court held, upon the facts as found by the Board of Tax Appeals, that the benefits retained by the taxpayer blended with the normal concepts of full ownership, so that the fact finding to the effect that the husband remained the owner of the corpus could not be considered reversible error. As to the *Tower* and *Lusthaus* cases, the Circuit Court declared that those cases were not controlling because of the Tax Court's finding in each that the wife was not a genuine partner.

Under the reasoning of the *Feldman* case just discussed, it becomes exceedingly important to bear in mind that in the case at bar *there was no fact finding by the*

Tax Court that the trusts were invalid or that the partnership was a sham.

The Tax Court did conclude as a matter of law that the trusts were invalid for trust purposes.

Nevertheless, a legal conclusion is not the same as a fact finding. Since the courts have laid so much stress upon the findings of fact of the Tax Court or equivalent lower court, the distinction cannot be overemphasized.

In the light of that stress, the failure of the Tax Court in the case at bar to render a fact finding adverse to the trusts as members of the partnership becomes crucial.

This Court has not yet passed upon the validity, under the taxing statute, of gifts of partnership interests to children—as distinguished from wives.

In view of the multitude of family partnership cases, the question whether the doctrine of the *Tower* and *Lusthaus* decisions is to be extended to situations involving children is likely to be of considerable public interest.

It would seem important, therefore, that any doubts as to the validity or invalidity of partnerships with children be resolved by a definitive decision.

The rationale of the partnership and trust cases involving wives is that a division of a husband's property or income with his wife does not actually render the husband the poorer. Husband and wife are regarded as a single economic unit. The courts consider that a diversion of income from a husband to his wife does not deprive him of an economic benefit, and does not constitute an actual diversion.

That theory of unity has not thus far been extended by this Court to cover children. It is submitted that no such unity exists in their case.

In the matter at bar, there was no retention of income within the family groups. The petitioners had put permanently beyond them the enjoyment of the group income. The trusts provided for the accumulation of income for

the minors. Neither the petitioners nor the wives could receive that income. Presumably, the children would eventually marry and set up separate family establishments by the time they came into enjoyment of the trust income or corpus. The income thus would flow to different and independent family groups from that constituted by Eisenberg and his wife, or by Schaeffer and his wife.

On that reasoning, it is submitted, both the Tax Court and the Circuit Court erred in concluding that the arrangements made by the petitioners did not change their economic status but merely multiplied a single economic unit. The rationale of the *Clifford, Tower* and *Lusthaus* cases should not be carried to the point of governing the present case. A clear line of demarcation exists. That line, it is urged, should be maintained intact.

B. Remand for Fact Finding.

One further point remains to be considered. As has been brought out previously, the Tax Court made no fact finding as to whether or not the settlors still remained owners of the trust property, or as to whether or not the trusts actually became partners. That issue, as has already been argued, is vital in the case at bar. At the very least, therefore, this case should be remanded for a finding of fact by the Tax Court on that disputed issue.

Authority to that effect appears in a very recent case reported in the advance sheets of the Federal Reporter for July 7, 1947: Commissioner of Internal Revenue *v.* Stinchfield's Estate, 161 F. 2d 555 (C. C. A. 9th, April 29, 1947).

In that case, the Commissioner had contended that a transfer of stock was made (*a*) in contemplation of death or (*b*) to take effect in possession or enjoyment at or after death. The Tax Court decided the first issue and

found that the transfer was not made in contemplation of death. Believing that the Commissioner had abandoned contention (*b*), the Tax Court failed to pass upon the second issue.

The Circuit Court, holding that the Commissioner had not abandoned the second contention, reversed and remanded the case for a fact finding on that issue. The Circuit Court's opinion declared (p. 556 of Report):

> "Since it is the intent of Congress that such an issue of fact should be first determined by the Tax Court, we reverse its final determination that the shares be not included in the decedent's estate and remand the case to that court with instructions to make such determination. * * *
>
> "Reversed and remanded."

That ruling applies squarely to the instant case. A vital fact finding is lacking. As a minimum requirement, it is urged, an order of reversal and remand is appropriate so that the Tax Court may supply the missing fact finding.

CONCLUSION.

It is, therefore, respectfully submitted that for the foregoing reasons your Honorable Court should grant the Petition for Writs of Certiorari.

Respectfully submitted,

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By

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